DOW THEORY LETTERS INC.

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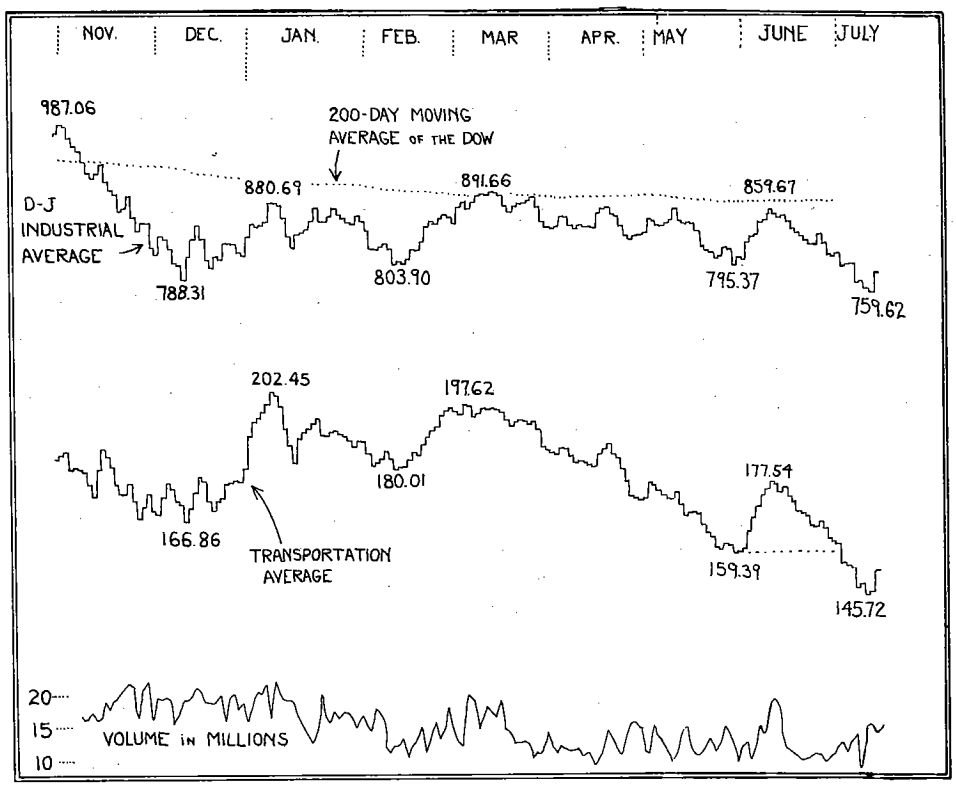
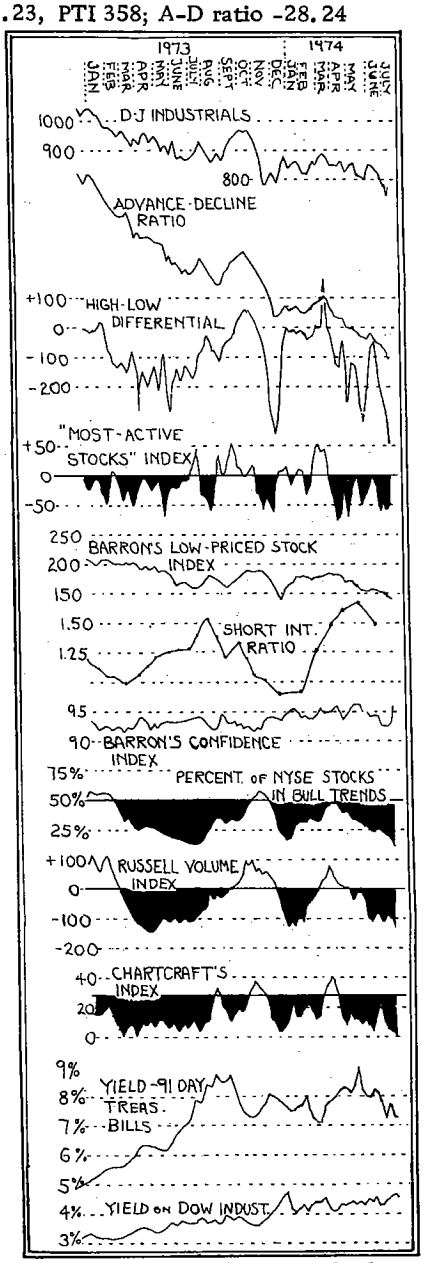
July 5, DJIA 791.77; PTI 372; A-D ratio -27.58
July 12, DJIA 787.23, PTI 358; A-D ratio -28.24

THE MARKET: I keep a market diary which lists statistics and facts for each day's action. By any reckoning, Wednesday, July 10, was a milestone. Here's what the diary showed. The D-J Industrials dropped 10.17 points to close at 762.11, lowest level since mid-1970. The D-J Transports gave up 2.87 points to close at 149.99, their first trip under the 150 level since late-1970. The Utilities that day sank 1.03 points to 65.98, lowest level since 1957. The D-J 40-Bond Average closed at 66.92, lowest point since November, 1970. Not to be outdone, the advance-decline ratio fell to its lowest level since the 1940's, the Primary Trend Index (PTI) closed at a new bear market low, and the cumulative most-active stock index (see Letter 601) dropped to the lowest figure for which I have any record. As an extra attraction, bellwether General Motors set off its own "bear signal" by breaking to a new low for the year. Conclusion: the bear has been digging in with teeth and claw, and the blood is flowing.

A much more orthodox conclusion is as follows: the D-J Industrials on July 8 broke their critical 1973 low of 788.31. Two days later Transports confirmed on the downside by violating their own 1973 low of 151.97. Such action, if it had occurred during a presumed primary bull market, would have been called a classic "bear signal." But since a primary bear market has been in progress since February, 1966, I simply accept the joint penetrations of the Averages on July 8 and 10 as another ominous "bearish" signal, a signal which should nevertheless be treated with respect by anyone who has even passing acquaintance with the Dow Theory or the technical approach to the market.

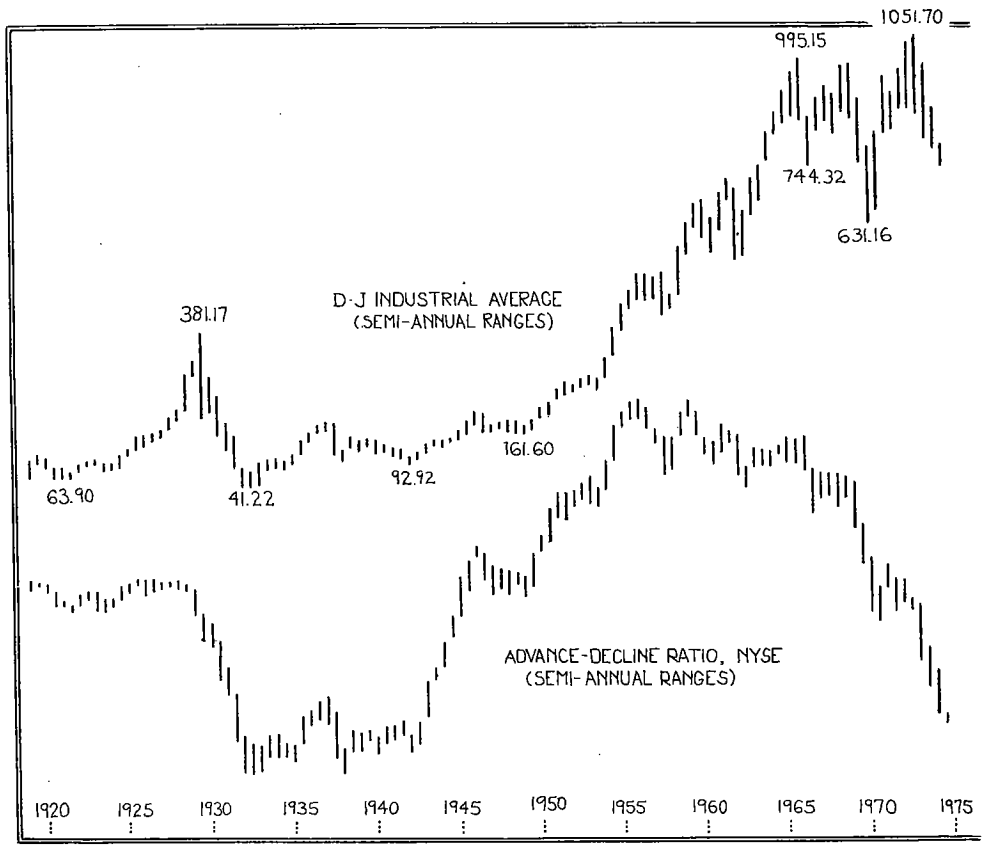
It is typical of corrective movements (against the primary trend) that they are sudden and violent, often making up in a day or so what it took weeks to produce in the primary direction. On July 12 the Dow "bounced" up a few dozen points in characteristic bear market fashion, but it remains to be seen whether this latest explosion will be able to revive anything in the way of sustained market enthusiasm.





Personally, I doubt it, but then every dog has his day, and every bear market has its important secondary corrections. On the larger picture, the next market major points for the bears are the 1970 primary lows: these are 631.16 on the D-J Industrials, 116.69 for the Transports. The 1970 Utility low of 95.86 was violated last August, 1973. Those who have followed these reports for any length of time know that I consider the

Utility movements to be harbingers of things to come.



NO CRYSTAL BALLS: Everybody likes certainty. Consciously or unconsciously, the majority of people seem to be willing to give up their freedom for certainty. Unfortunately, the quest for certainty provides the psychological foundation for both fascism and communism. Both of these totalitarian systems are predicated on the thesis that "our leaders" know more than we do, and that a system that tells you what to do is going to be righter than a system which insists that you tell yourself what to do.

All of this is another way of saying that people are afraid of taking responsibility for themselves. In my own experience, I would say that all personal advancement (in whatever form of endeavor you choose, psychological, business, art, politics, etc.) must entail your taking increased responsibility for yourself. The process of assuming responsibility for your own actions is usually frightening. Suppose you are wrong? Suppose you tell a friend that you resent something he said, and suppose he gets angry? You took responsibility for saying how you felt and you got slapped down for it. That's frightening.

The daily examples are endless. You decide to buy a certain stock and it goes down. Your spouse accusesyou of idiocy — it's painful, but you did assume responsibility for the choice. Of course, it's easier to give the responsibility to your broker. Then if the stock goes down, you simply tell your spouse that the broker is an idiot. That's much easier, it's less painful. But there is a catch to avoiding responsibility, and there's a plus to assuming it. Each time you take responsibility for your own action, you get stronger. Each time you avoid responsibility, you stay weak or get weaker. All growth, therefore, entails the pain of taking responsibility for your actions (right or wrong).

Then there is the matter of being wrong itself. If you are wrong in an action (whether it's making a decision, making an investment, expressing an opinion, etc.) so what! What law says that you have to be right all the time or any of the time? Who says you have to be a genius or brilliant or even smart? If your spouse or your boss or your kids demand that you be right on this or that, tell them you do the best you can, and that's all you are offering today. Try that next time they berate you (and you torture yourself) because you aren't performing on a level that meets with their expectations.

All of which, believe it or not, brings me to an area where I like to be (or at least hope to be) intelligent: investments and the stock market. I've been writing about this primary bear market ever since it began in February, 1966. At that time I was firmly convinced that the great 1949-66 bull market had breathed its last, and that a great bear market was being ushered in. I may have looked like a damn fool (and a stubborn one) on occasion, such as during the great bear rallies of 1967-68 and 1970-71, but taking the whole period of 1966 to date, I'd say that those who followed my logic and views have done a great deal better than those who didn't.

One thing about the stock market, however, is that it never lets you rest. It always keeps you sweating, hoping, pondering, and wondering whether tomorrow you are going to start being utterly wrong and looking like a complete fool. Furthermore, as I have often written, a primary bear market is an "economic enemy" second to none. It is out to part you from your money, to destroy you financially if it can. A bear market (to my mind) acts like a diabolical living thing. It waits to see where the greatest number of investors are hiding, and then it systematically destroys them.

Are they hiding in "growth" stocks? Down with growth stocks. Are they hiding in OTC shares or in "natural resource" shares? Well, they go next. Oh, now they're in bonds and utility stocks. To the cleaners with them. You feel that bank deposits and overseas deposits will foil the bear? Well, here goes the bear for the throat of the banks. Mutual fund, professionally managed growth funds; take this my friends, destruction compliments of the bear. Let's see, what's left, hmmm, gold shares, gold coins,

US Treasury bills. Well, let's just knock bullion on the chin a few times, and see if we can't scare out the gold-freaks. And T-bills, well, the bear may be working on that one right now.

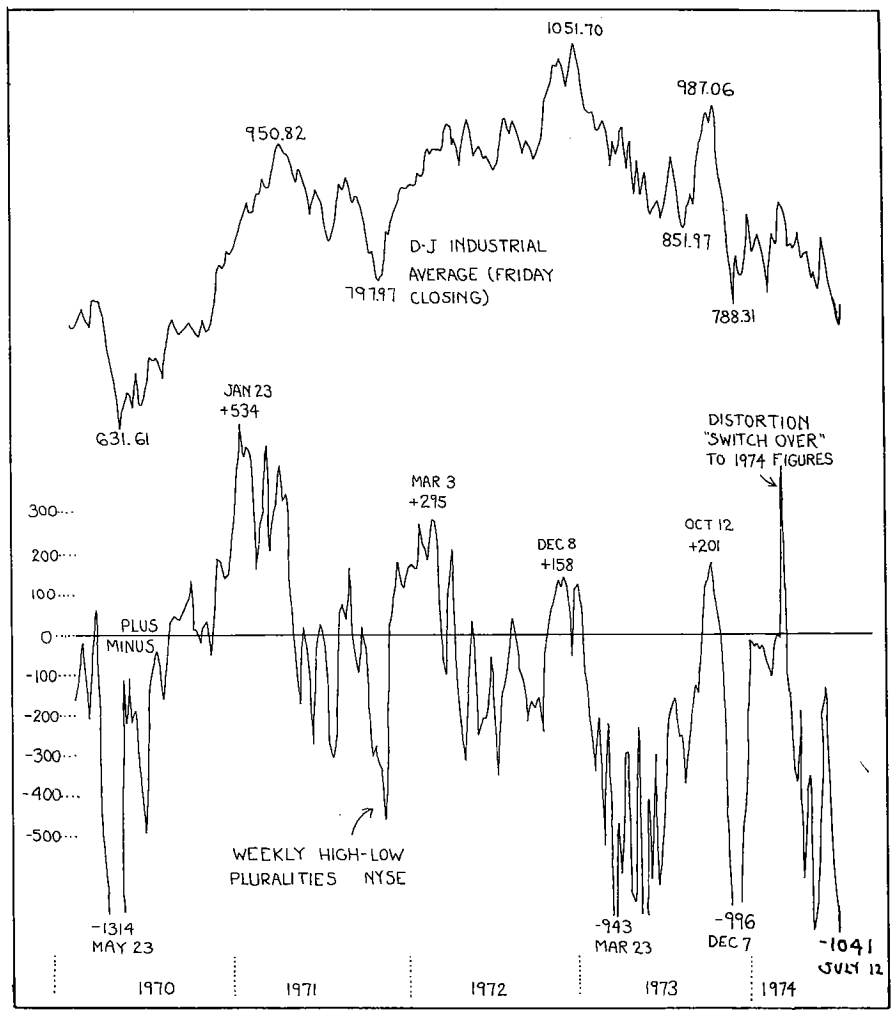
Now, this is where Richard Russell has to take responsibility. I can't tell you to get the picture from the Wall Street Journal or your local astrologist or the millionaire with the beady eyes who lives up the street. The Journal will only tell you what happened yesterday, the astrologer probably can't tell you that much, and the millionaire wouldn't tell you if he knew (unless he has something to gain from it). So I have to put myself on the line. I have to tell all I know. If I'm not delivering what I'm being paid for, or if I don't know — I have to say that too, because my subscribers are an exceedingly shrewd bunch, and if I lie or slice just a little bit of baloney they'll spot it in a minute. Then it's "hide under the desk, Russell," and if the phone rings (let's really avoid responsibility) tell them I just left for Johannesburg to see if Vaal Reefs is actually mining gold.

I am now going to say that I'm amazed and even a bit puzzled. I'm including a chart (page 2) that's an exclusive with me, a semi-annual chart of the advance-decline ratio and the Dow from 1919 to date (high low ranged for each six-month period since 1919 are shown). Perhaps this chart, more than any other, serves to document the catastrophe which has befallen NYSE issues (and obviously, all other US issues).

Here we see that A-D ratio in a plunge which began in the first half of 1971 and which has continued to the present. This movement has now consumed a period of three years, and it was preceded (aside from the little 1970-71 rally) by the violent smash of 1969-70! I can't speak for any other analysts, but to my mind the market is telling us something in no uncertain terms.

You just don't get this kind of horrendous destruction as a pure technical correction. I believe that the ongoing cascade in the A-D ratio is telling us that we are in for a period of massive change in our economy. The fact is that the market, as measured by the A-D ratio (which is as broad an index as I know of) has taken a beating which can only be compared with that of 1929-32. The 1929-32 collapse was followed by a depression of unprecedented severity. And while no two primary bear markets are exactly alike, I believe that we may be going into a period of economic upheaval which will present as much pain and as many problems as did the period of the 1930's.

I don't say we will have an economic depression, pure and simple. Obviously, I don't know exactly what is in store for us. But I do think we will have a sweeping series of changes in our monetary system, a great revolution in our spending and debt management. We could see a near wipe-out of the pension funds and a collapse of many institutions. We could witness a tottering of such unfunded monsters as the Social Security system. I really don't know the answers, but I do know that technical destruction on the scale that we see on this chart is providing us with a message. "When coming events cast their shadows before, those shadows fall on the NYSE." (William Hamilton).



WEEKLY HIGH-LOWS: In describing the saintly but mysterious hero of his great novel, "The Idiot," Dostoievski wrote, "Be simple and rediscover the world." In technical analysis, as in other areas, simplicity often works best. One of the areas of market analysis which is always worth studying is the one dealing with new highs and lows on the NYSE. Analysts use the high-low statistics in any number of ways. Some use the raw figures, some use daily pluralities, some use moving averages or ratios. I follow four different methods, but one of the simplest and most satisfactory is the method which was presented last in Letter 582. This is the plurality of the weekly figures as they appear in Barron's. For instance, if during a week there were 700 new lows and 200 new highs, the plurality would be minus 500. And that's all there is to the accompanying chart

 showing the weekly pluralities going back to 1970.

The weekly pluralities of the high-lows, if drawn correctly, should present a long-term picture. And it is the long-term which is the most important to investors. With that introduction, let's turn to the chart. New subscribers may be surprised to note that the peak of market strength, as measured by the high-lows, occurred on the week ending January 23, 1970. The figure for that fateful week was plus 534. From there, we saw a steady drop-off in the high-low peaks: 295 at the March, 1972, peak, and then 158 at the December, 1972, peak. This steady technical deterioration on each rally gave way to the severe 1973 smash in breadth and the decline in the Dow to 851 (August, 1973).

Next, we had the rally to 987 on the Dow (October, 1973), but note that here we had a rather unimpressive reading of 201 on the high-lows. Another drop ensued with the Dow falling this time to the December, 1973, low of 788. The 1974 market rise was a fizzle, and the one-week peak in the high-lows was a freak caused by the March switch-over to the new high-low computations (each March all the old statistics are erased, and any high or low made since January is considered a new high or low for the new year).

Thus, we can see that the weekly high-low pluralities constitute a good method of gauging market strength on the upside. To put it bluntly, we haven't had any impressive upside strength since 1970, judged by this method.

Downside interpretation is a bit trickier. For instance, downside high-low figures can appear "hopeful" for a time (in that they do not expand beyond a previous low), but then a sudden burst of weakness can send the new lows roaring. In general, I consider any downside reading of minus 1200 or more as being of "climactic" proportions. When we get a minus 1200 or more, I feel that we can start looking for at least a good secondary bottom.

Now note the minus 1314 plurality of May 23, 1970. That week proved to be "take the gas" week for the frightening 1970 crash, but it was also the week which identified a major secondary bottom. The next big decline occurred during 1973, and here we saw a minus 943 on the index (March 23). That figure was less than the required minus 1200 and therefore could not be considered climactic. On December 7, 1973, we witnessed a minus 996, bearish in that it exceeded the March low figure of minus 943 — but still not climactic.

Last week (July 12, 1974) produced a plurality of minus 1041, the biggest downside week since May 23, 1970. Nevertheless, last week's plurality fell short of the climactic minus 1200 figure. For this reason, I would say that we could see an extension of the rally which began July 12, but the rally would be suspect. My feeling is that the market will turn down again, and we will see a minus 1200 or more on the high-low index prior to the next important secondary bottom.

GOLD: There is an old adage which states that one "can't see the forest for the trees." Ironically, I have found this to be generally true of the citizens of South Africa regarding gold. They produce 70% of the world's gold, they live in a golden land, yet I have always found the S. Africans to be rather skeptical of gold's future. I guess they waited so long with gold at $35 an ounce that even though it is considerably higher now, they still retain their pessimism, born of decades of waiting for higher gold while the price of everything else rocketed (my subscriptions from S. Africa have climbed significantly this year, and I believe that the reason is the gold correction, the inherent worries which S. Africans harbor about gold, and their wish to hear my more optimistic view regarding the gold picture).

There is a man from S. Africa who is both astute and verbal regarding gold. He is Fred Macaskill (Market Indicators Digest, PO Box 17389, Johannesburg, S. Africa 2038). I have been exchanging reports with Fred for years, and in his last (July 1) Fred brings out a very important thesis. It is that "Every step in the demonetization of gold has been followed by a rise in the price of the metal." With that in mind, let's go over a bit of history.

(1) The first modern step in gold demonetization occurred in the 1920's when the world left the Gold Standard. In 1934 the Gold Exchange Standard was created (reserve currencies were then pronounced to be "as good as gold," a step in demonetization), but it is well to note that gold was also raised in price from $20.66 to $35 per ounce in 1934.

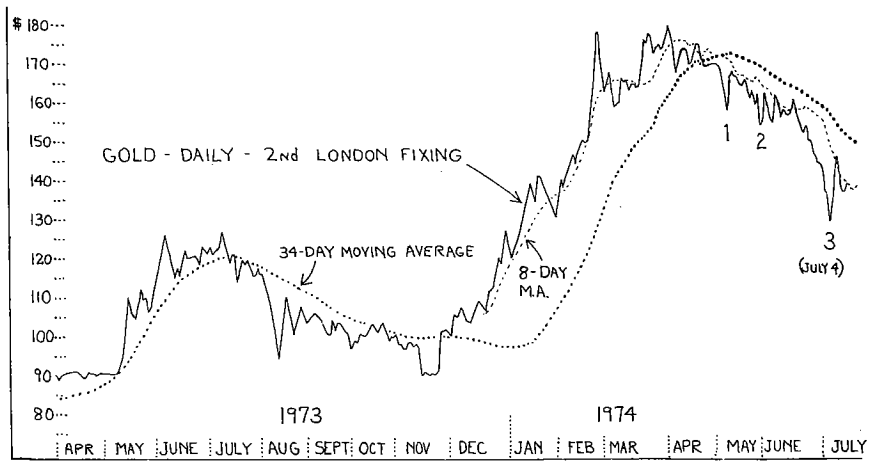
(2) 1968 saw the entrance of the "two-tier" gold system, and this allowed for two gold prices, the $35 official price and a free market price. The free gold market was another step in gold demonetization. The free market price for gold reached $42 in May, 1968.

(3) On August 15, 1971, the US suspended the convertibility of the dollar, a landmark in the history of gold demonetization. This was the end of gold as a backing for the dollar, the "official" US price for gold was raised to $38, but towards the end of 1971 gold (free market) rose to $44.

(4) December, 1973, the two-tier gold market was disbanded. Thus the inauguration of the two-tier market set up a free market price, an important step in demonetization, and the breakup of the two-tier market pulled the props out from under the US official price (further demonetization). The price of gold by December, 1973, was as high as $128.

(5) June, 1974, the SDR link with gold was destroyed. The SDR was now "a basket of currencies" (all of them floating). Thus, the SDR had become a ship without a rudder, and gold was further demonetized. It will be interesting to see whether this latest step in the world trend to gold demonetization will result in new high prices for the yellow metal. In my opinion, it will. Furthermore, I believe that the longer the world continues without gold in the monetary system and the longer the world avoids the discipline of gold, the higher the ultimate price for gold. Five thousand years of history suggest that I am correct in this view.

A great many people have been concerned (even panicked) by the latest drop in the gold price. It is important to remember that gold ran up from its 1971 price of $35 to a July, 1973, peak of $128. It then broke to a November, 1973, low of $90. From there it rallied to an April high of $179.50 (second London fixing). At that time there was a great deal of publicity regarding gold and much speculation as many newcomers climbed aboard the gold wagon.



The 1974 correction (so far) has assumed the form of three downward zig-zags, thereby following the general pattern of the 1973 correction. I have marked the three sets of descending zig-zags on the accompanying chart. The first of the 1974 zig-zags took bullion to $156.50. The second zig-zag brought gold down to $154.50. The last took gold back to July 4's $129.

Actually, I feel that the third downward zig-zag could well have ended the 1974 gold correction, but we should give it a few more weeks to make sure. Note that the third downward plunge in gold (occurring July 4) gave us a "spearpoint bottom," and these are the kinds of bottoms I like best. They usually indicate a purging of margins, a cleanout of weak hands, and a healthy bottom.

It is fashionable to say that the 1974 gold correction has been terribly harsh, brought on by "unusual" news events such as the Herstaat bank collapse, record interest rates, Italian selling of some gold, Treasury Secretary Simon's threat to sell US gold if gold is legalized here, etc. I don't really subscribe to that line of thinking. I do believe that large interests are trying to get all the gold they can and at the lowest possible prices.

The gold markets of Zurich and London are actually quite small. They can be easily manipulated over the short-term. I am certain in my own mind that that is what has been happening. But it is well to remember that the primary trend cannot be reversed, only temporarily manipulated. And gold is in a primary bull trend. The longer gold holds in this correction area, the bigger the ultimate move when bullion betters the old $182 peak. Right now gold is looking nearly "sold out" to me. On July 11 bullion dropped to $130 for an hour or two, then jumped back to $137 on the second London fixing. I would say that we're very near the "sold out" point in bullion, and that the next major move is going to be up, way up!

Question: What does the collapse of the A-D ratio, the Utilities and the Bonds mean? Answer: I am still placing very great emphasis on the D-J Utility and 40-Bond Averages. The 40-Bonds are a broad measure on the credit markets, the Utilities are heavily dependent on the credit markets and tend to sell to some extent (as is the case with bonds) on a yield basis. Both the Bond and the Utility Averages have been plunging to new bear market lows. The current action of these two bellwether Averages is, to my mind, nothing less than catastrophic. From their 163.32 peak recorded in 1965, the Utility Averages (at its current 67 price) has lost 59% of its value. From the 109.73 peak of 1946, the 40-Bond Average (at a current price below 67) has lost 39% of its value. Yet the trend of both of these indices continues down. If these trends continue I would have to say that we are seeing the virtual destruction of our equity and credit markets. Frankly, I don't think anyone has ever seen anything like it (in 1929-32, at least the credit markets held intact, and bonds actually remained in a long-term bull market!).

Question: What do you mean, destruction of the credit markets? Answer: Perhaps I can best explain it in terms of that "new word," indexing. Suddenly, all the Keynesian economists are waxing poetic about Brazil's system of indexing, in which wages, utility bills, pensions, rents, everything is tied to the cost-of-living index. Everything goes up together, and Brazil just last week announced its sixth (!) devaluation. Our ding-bat economists think we can bring indexing to the US and thus avoid the destructive results of inflation while still retaining inflation.

But the US is a credit society. Brazil is not. Brazil has no annuities, no insurance companies, no bond markets, no real credit system. Indexing in the US would wipe out the bond market, destroy all savings, make it totally impossible to finance anything in the credit markets (unless there were gold guarantees). In other words, inflation wipes out a credit society by destroying its credit markets.

And that is what is happening in the US today. The steady inflation and the persistent rise in wages and prices has produced an unwritten indexing effect in the US. The credit (money) markets have finally grasped the picture, and they are now self-destructing. You cannot have steady inflation (a form of indexing) in a credit economy such as this one. The debt structure cannot take it, and when a trillion dollars in debt starts strangling and toppling over, well, all I can say is "get out of the way."

Question: How do you protect yourself against this situation? Answer: The only answer I have is that you try to protect yourself with gold and gold shares. One theory is that when the US moves into deflation, recession and unemployment, we'll have hyper-inflation by the government in order to get us out. If they can do it, they'll try, but I'm not sure they can do it. My friend Bill Tehan believes we're moving into the greatest credit collapse in history (and on a world scale). Either way, you have to have gold.

Question: I understand why you'd want gold during hyper-inflation, but why during a credit collapse? Answer: Because if the world monetary system goes under, governments may cancel all debts, cancel all paper, cancel anything they damn please and start over with a new system. There's one thing they can't cancel, however, and that's real money, gold. Gold will still be real money, and gold mines will still produce real money. Whatever "new currencies" emerge following a possible titanic credit collapse will certainly be purchasable with gold.

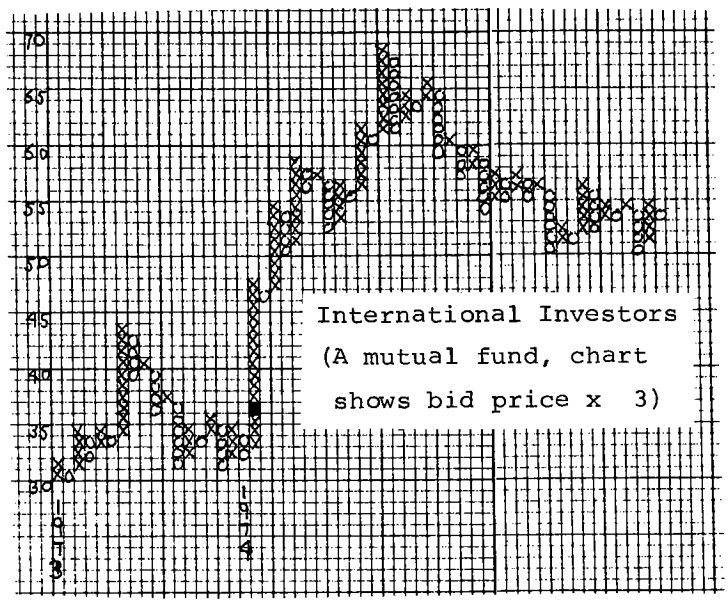
Question: But wouldn't they confiscate your gold shares too? Answer: Maybe, but what for? I don't think the US Government (given a credit collapse) would confiscate property, assets or stock shares. It wouldn't make sense. It isn't the assets which strangles the nation during a credit collapse, it's the debt! And that is what the government would cancel.

Question: In other words, you're saying that if we have a credit collapse and depression people might want gold and gold shares not so much for appreciation potential but simply because gold represents real money. Answer: That's right.

INVESTMENT POLICY: My policy for myself and subscribers is, and always has been, to stay out of primary bear markets and be invested in primary bull markets. There is only one bull market now, gold and gold shares. I have been trying to keep subscribers fully invested in gold shares, and as an aid, I also try to provide a running account of the technical and fundamental gold picture.

My gold momemtum chart (no room to show it in this issue) has now bottomed out and given its first upside zig-zag. This is a bullish indication and suggests that gold shares should soon be moving up. Both the S. African gold shares index and Barron's gold share index traced out their first important upward zig-zags on the chart last week. I consider this a definite plus for gold shares.

One of the very best gold indicators (for me) has been the P & F chart of International Investors, a mutual fund 90% invested in golds and precious metals. I include my own chart of the fund here. This is the pre-split stock, showing the double bottom of late-1973, the upside breakout (solid black square) was 37, and that breakout signalled the great rise in the gold shares.



Now we have another beautiful double bottom at the 51 level, a nice accumulation (under the guise of all kinds of "bad news" for gold), and more backing and filling. Look under the mutual funds column in your newspaper. When International Investors hits a bid price of 19, this will be its first new bullish signal. At 19.33 we will have a second signal fully comparable to the black square signal of 1973. Then it should be a major upward move in golds (the current quotes on Int. Inv. have to be multiplied by three if you wish to keep this chart up as the stock was split three for one).

Unquestionably, the two golds that are acting as bellwether leaders here are the two that I have probably recommended more than any others. First is Homestake, second is ASA. Every subscriber should have these two stocks in his portfolio. If you have the individual S. African shares, of course, you own what ASA owns, and you don't necessarily have to have ASA too.

I have written much about Homestake, but I might as well write a bit more in the hopes of getting the remaining subscribers (who may not own a good chunk of this great company) into the shares. HM is the biggest gold producer this side of Africa. The company has been operating for almost 100 years, and the President recently predicted that HM would be operating 100 years from now. No one really knows how much ore HM has, but among other things it works about 7,000 acres of about 100,000 acres which it owns around Lead, S. Dakota. I have a feeling that one day, when HM's stock is ready for distribution (instead of the current accumulation) we will see some very exciting estimates on the size of HM's gold ore reserves, which have always been very conservatively understated. HM earned $2.49 for the four quarters ending in March — against .88¢ the year before! Nuff said.